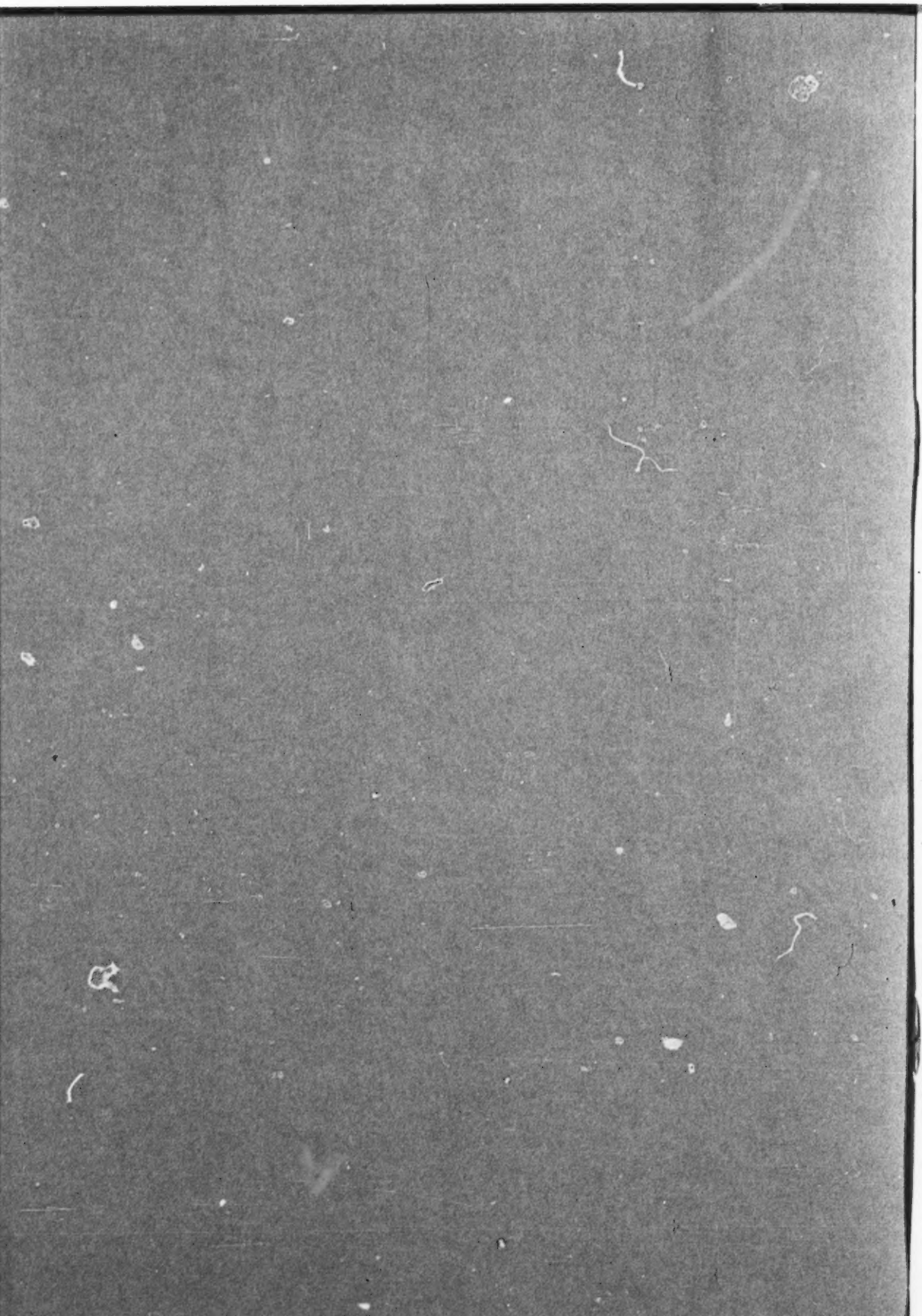

COURT OF APPEALS OPINION

No. 20251

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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434 F.2d 1011, 26 AFTR 2d 70-5837

NOVELART MANUFACTURING COMPANY,
Petitioner-Appellant,
v.
COMMISSIONER OF INTERNAL REVENUE,
Rsepondent-Appellee.

APPEAL from the United States Tax Court.

Decided and Filed November 27, 1970.

Before PHILLIPS, Chief Judge, and WEICK and EDWARDS, Circuit Judges.

PHILLIPS, Chief Judge. The taxpayer appeals from the decision of the Tax Court finding deficiencies for the fiscal years ending June 30, 1961, 1962 and 1963, respectively, in accumulated earnings tax imposed by § 531, Internal Revenue Code of 1954, 26 U.S.C. § 531.[1]

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1. § *531. Imposition of accumulated earnings tax*

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

The Tax Court agreed with the Commissioner in holding that the taxpayer was availed of for the purpose of avoiding income taxes on Klein, the sole stockholder of taxpayer, by unreasonably accumulating earnings and profits. The ultimate finding of fact of the Tax Court was that during each of the taxable years in question the taxpayer permitted its earnings and profits to accumulate beyond the reasonable needs of its business.

The findings of fact and decision of the Tax Court are reported at 52 T.C. 794, to which reference may be had for a complete recitation of pertinent facts. We affirm.

The accumulated earnings tax is discussed in some detail in *U.S.* v. *Donruss Co.*, 393 U.S. 297, reversing 384 F.2d 292 (6th Cir.), and in *Shaw Walker Co.* v. *Commissioner*, 390 F.2d 205 (6th Cir.).[2]

The accumulated earnings tax is imposed on corporations which accumulate their earnings and profits beyond the reasonable needs of their business for the purpose of avoiding the income tax with respect to their shareholders. Where an accumulation beyond its reasonable business needs has been permitted, the taxpayer has the burden of proving, by the preponderance of the evidence, that avoidance of income tax on its shareholders was not one of the purposes of the accumulation. *U.S.* v. *Donruss Co., supra.*

Applying the guidelines set forth in *Donruss*, we find no error in the decision of the Tax Court in the present case. We hold that the findings of fact of the Tax Court are not clearly erroneous, Rule 52(a), Fed. R. Civ. P., but to the contrary are supported by substantial evidence.

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2. In *Shaw Walker* the Supreme Court granted certiorari and remanded the case to this Court for further consideration in the light of *Donruss*, 393 U.S. 478. This Court thereupon remanded the case to the Tax Court. 412 F.2d 858.

We affirm for the reasons set forth in the opinion of the Tax Court.

Only two questions require further discussion. The taxpayer contends that: (1) it is entitled to a deduction, in determining its accumulated earnings tax, for premiums paid on life insurance on the lives of its key men; (2) that the tax as imposed violates the Sixteenth Amendment.

The short answer to the contention that a deduction should be allowed for life insurance premiums is that 26 U.S.C. § 535(b) provides for specific adjustments in computing the accumulated taxable income. That section does not authorize an adjustment in the form of a deduction for life insurance premiums. The taxpayer argues that the amounts paid out for life insurance premiums no longer were available for distribution and should not be included in the measure of the tax because the tax is imposed on what is accumulated rather than on what is distributed. This generalization is not consistent with the rules established by the Internal Revenue Code for calculating the accumulated earnings tax. Since the Code does not allow the deduction urged by taxpayer, if his contention has any merit, it is for consideration of the Congress rather than for the courts.

The taxpayer also asserts that it has accumulated earnings over a period of sixty years and as a result thereof, the tax imposed in the present case is on capital and not upon income and hence, results in a violation of the Sixteenth Amendment. We find this contention to be without merit. *Helvering* v. *Northwest Steel Mills*, 311 U.S. 46, 53.

Affirmed.

MEMORANDUM, FINDINGS OF FACT, AND OPINION OF THE TAX COURT

(52 T.C. No. 83)

(Filed August 11, 1969)

TAX COURT OF THE UNITED STATES

NOVELART MANUFACTURING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 3483-67 Filed August 11, 1969

Held, that the petitioner has not shown that it was not availed of during the taxable years in question for the purpose of avoiding the income tax with respect to its shareholder by permitting its earnings and profits for such years to accumulate instead of being divided or distributed, and that it is therefore subject to the accumulated earnings tax imposed by section 531 of the Internal Revenue Code of 1954.

Sol Goodman, for petitioner.

Rodney G. Haworth, for respondent.

ATKINS, *Judge*: The respondent determined deficiencies in income tax in the amounts of $10,734.55, $12,132.17, and $6,172.21 for the fiscal years ended June 30, 1961, 1962, and 1963, respectively.

The only issue for our decision is whether petitioner was availed of for the purpose of avoiding the income tax on its shareholder by permitting its earnings and profits to accumulate instead of being divided or distributed, with the result that the petitioner is subject to the accumulated

earnings tax imposed by section 531 of the Internal Revenue Code of 1954. Some of the facts were stipulated and are incorporated herein by this reference.

FINDINGS OF FACT.

The petitioner is a Delaware corporation whose principal office at the time of the filing of the petition was in Cincinnati, Ohio. Its Federal income tax returns for the taxable years here involved were filed with the district director of internal revenue at Cincinnati, Ohio.

During the years in question all of petitioner's outstanding capital stock was owned by Charles H. Klein, who was also petitioner's president. Klein and his wife filed joint Federal income tax returns during the calendar years 1961, 1962, and 1963. The maximum tax rates applicable to their income for those years were 62 percent, 65 percent, and 65 percent, respectively.

The petitioner was originally organized in 1906 under the name of Progress Lithographing Company. It carried on a lithographing, printing, and binding business in several plants, one being in Amberley Village, Ohio, and one in Lebanon, Ohio, and also engaged in research and development activities in this field.

In 1958 petitioner had begun to experiment at its Lebanon plant with a process of lithographing cardboard for use in making corrugated cardboard boxes. Lithographing of such cardboard was a new concept, and at that time no other company was engaged in such an enterprise. In furtherance of this project, petitioner purchased some new machinery and, using it with its old facilities, began to lithograph the cardboard on an experimental basis. It employed a market research firm to study the market demand for such a product in order to determine whether to

continue the project. The results of the study were highly favorable, and the petitioner determined to enter this field on a commercial basis.

At a directors' meeting held on February 9, 1959, Klein informed the directors that he had begun a search for another plant site because of the necessity for additional factory space due to changing requirements of the business. He stated that it would be necessary to either expand the Amberley plant or build a new building on another site. The directors instructed Klein to prepare an outline of petitioner's anticipated future requirements with a comparison of the cost of a new plant addition and that of a complete new building on a new site.

The minutes of a meeting of the directors of petitioner held May 5, 1959, contain the following:

> Due to the company's undertaking the lithographing of folding boxboard during the past few years and its increasing volume, additional floor space for this kind of work and to serve the new machinery and equipment [being moved to the Amberley plant from another plant] is urgently required. Folding boxboard normally needs approximately five times as much floor space as paper stock of similar size because of the respective difference in thickness. The President also reported to the Directors that preliminary layouts were completed and floor plans would be ready at an early date for both a new factory addition and a complete new plant. The President was instructed to obtain preliminary cost estimates based upon these plans, so a decision could be reached to adopt either plan.

At a meeting held on July 15, 1959, the directors authorized expenditure of such sums as might be necessary to continue the promotion and development of proprietary products, subject to the control of Klein in the exercise of his best judgment.

About January 1, 1960, the petitioner's name was changed to Novelart Manufacturing Company, and a subsidiary was formed and given the name Progress Lithographing Company (hereinafter referred to as "Progress"). Petitioner then transferred to Progress all its manufacturing assets necessary to operate its lithographing, printing, and binding business, and received in exchange, among other things, 80 percent of the voting stock of Progress. Thereafter Progress carried on the operating business previously engaged in by petitioner, while petitioner continued its research and development activities.

Progress undertook to carry on the business of lithographing cardboard. However, it did not achieve the financial results which it sought and it produced only limited quantities of lithographed cardboard. Klein then conceived the idea of fabricating the lithographed cardboard into boxes. It was not then definitely decided whether petitioner or Progress would perform this fabrication process. This fabrication would require additional manufacturing space, and in January or February 1962 the petitioner examined a plant at 4501 West Mitchell Avenue in Cincinnati, which had previously been used as a box factory. This plant consisted of a building which contained over 100,000 square feet, was located on a railroad siding and was accessible to Progress' plant, and had machinery which could be utilized after modification. This plant would provide both manufacturing and storage space. The asking price for this plant at that time was about $1,500,000. However, there were no takers and the petitioner felt that the price was too high. In August 1962, petitioner reexamined the plant, at which time the asking price had been reduced, but the petitioner still believed the price to be too high. The petitioner continued to negotiate for the plant, and in September 1962 entered into a contract to purchase

it for $530,000. The property was transferred to the petitioner on November 12, 1962. The total cost of the acquisition was $532,000.

Thereafter, in the latter part of 1962, the president of Progress, Sundermann, died, which disrupted the plan with respect to the utilization of the Mitchell Avenue plant. Such property remained vacant for about a year, after which time petitioner rented it to Litho Carton and Container Company (formerly R.A. Taylor Corporation) a subsidiary of Progress.

About the end of 1962 Klein and two of his associates conceived the idea of a new type of machine for manufacturing corrugated paper board which would permit the offering of a greater variety of sizes of paper for the manufacture of cartons and would at the same time result in faster production and less cost. In view of this new development, Progress ceased lithographing cardboard in order to modify its facilities. Due to the death of Sundermann the machinery changeover was not accomplished until sometime in early 1963. In the spring of 1963 Progress resumed operations, employing the new process. Klein and his associates filed an application for a patent on the new type of machine on May 20, 1963, and the patent was eventually issued on February 28, 1967, and was assigned to the petitioner.

Sometime in 1967 the petitioner purchased a plant in North Vernon, Indiana, at a cost of between $750,000 and $1,000,000.[1] At the time of the trial in 1968 machinery was

1. The need for an additional plant was discussed at a meeting of the petitioner's board of directors on June 20, 1966, the minutes of which state in part:

> The Directors then discussed the property owned by the Corporation and located at 4501 West Mitchell Avenue. This property is presently rented to the corporation's subsidiary. It was brought out in the discussion that this building is rapidly being filled with machinery, raw materials, work-in-

in process of being built for the plant and petitioner anticipated that the total cost of the plant and work in process might run to $1,500,000.

During the taxable years in question petitioner had no specific and definite plan to purchase this or any other particular plant, aside from the Mitchell Avenue plant. It did contemplate that at some time in the future some expenditure would be made for additional plant facilities, but it was not known what amount would be expended since this would depend upon the market at the time of purchase and the facilities that would be required.

The minutes of a meeting of petitioner's directors held on July 15, 1959, contain the following:

> RESOLVED: That the expenditure of such sums as are necessary to continue the promotion and development of proprietary products are hereby authorized subject to the control of Charles H. Klein, President, in the exercise of his best judgment.
>
> * * *
>
> Discussion followed concerning continuation of established policies of acquisition and expansion. * * * The President indicated that he would continue his activities with respect to the purchase of other companies as he felt each acquisition would be carefully considered on its own merits when presented.

The minutes of the meeting of June 17, 1960, contain the following statement:

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process and finished goods inventories. The Directors were reminded that when this building was purchased, it was at that time considered in the nature of a stop-gap because of the subsidiary's need for space to meet the increasing requirements of the PRE-LITH corrugated larger building. They were reminded that it is customary for 500 sheets of PRE-LITH corrugated material to be stacked on a single skid. With the subsidiary now receiving single orders amounting to hundreds of thousands of pieces, it is apparent that increased space will be needed.

Charles H. Klein, President, stated that the major purpose of the meeting was to consider the utilization of the corporation's earnings and profits for the current fiscal year and to consider the reasonably anticipated needs of this corporation's business and the business of Progress Lithographing Company with respect to said earnings and profits. He pointed out that the officers and directors of this corporation and of Progress, in which latter corporation this corporation owns 80% of the voting common stock, have undertaken an active program to acquire other business enterprises through purchasing the capital stock or assets of other corporations; and in view of this business acquisition program he stated that in his judgment there should be no declaration of dividends in excess of $30.00 per common share by the Directors of this corporation with respect to the corporation's earnings and profits for the current fiscal year. He pointed out further that this business acquisition program will require the utilization of the current year's earnings and profits by this corporation to acquire these businesses or by Progress to acquire such businesses.

* * *

RESOLVED: That the proper officers of the corporation be and they are hereby authorized and directed to take all necessary action to carry out the aforesaid business acquisition program on behalf of this corporation and of Progress Lithographing Company and to utilize the earnings and profits of this corporation for such business acquisitions.

The minutes of a meeting held on July 26, 1960, contain the following:

Discussion followed concerning continuation of established policies of acquisition, investment and expansion. The President indicated that he would continue his activities with respect to the purchase or investment in other companies and would bring to the attention of the Board of Directors each situation deemed

worthy of consideration on its own merits within the framework of the resolution adopted as an Amendment to the Articles of Incorporation at the Special Meeting of Stockholders held on December 28, 1959.

The minutes of a meeting held on June 18, 1960, contain the following:

> The President then stated that he had been continuing discussions with U. Gordon Colson, President, of U. O. Colson Company with respect to the acquisition by this corporation of a capital stock interest in the U. O. Colson Company; and that these discussions up to this point have been successful. The President further advised that in all probability he would be elected to the Board of Directors of the U. O. Colson Company and that this corporation would be afforded the opportunity to make a considerable investment in the capital stock of the U. O. Colson Company. After discussion and upon motion duly made, put, seconded, and unanimously carried, the following resolutions were adopted:
>
> RESOLVED: That Charles H. Klein, President, be and hereby is authorized to take all necessary action to invest funds of this corporation in the capital stock of the U. O. Colson Company.

* * *

In 1957 or 1958 Klein first became interested in the possibility of purchasing for petitioner an interest in the U. O. Colson Company, which manufactured lithographed calendars. That company was not a supplier, customer or competitor of petitioner. Sometime after June 18, 1960, Klein was elected a director of U. O. Colson Company. From time to time Klein discussed with its president, who owned a majority interest and who was anxious to get some capital out of the business, the possibility of the purchase of an interest. However no interest was

purchased and in late 1967, when the assets of the Colson Company were sold, Klein abandoned any thought of purchasing any interest in such company.

Sometime prior to July or August 1960, petitioner became interested in producing paper shredding machines for sale for office use, and considered purchasing a company already in that business. However, due to the fact that such business was not protected by a patent, petitioner decided instead to establish a business of its own in that field. Establishing such a business involved the designing of a product, the building of manufacturing equipment and the establishment of manufacturing and sales operations which, if carried to the point of distribution and sale, would have involved expenditures of $200,000 to $300,000. In July or August 1960, a subsidiary, Electroshred Corporation, was formed to carry on this operation. However, due to the unexpected death of Progress' president toward the end of 1962, Klein was forced to direct his energy to the active management of Progress, and this paper shredding project was discontinued. During the years here in question, petitioner invested about $50,000 in this venture.

In November 1960, petitioner began a "plastic lid project". At that time lids for containers such as cottage cheese cans were being made of metal. Petitioner originally planned both to print a design upon plastic discs, and to form the plastic discs into lids. The R. C. Can Company, a large paper manufacturing company, was also considering the manufacturing of plastic lids. It prevailed upon petitioner to agree to make only the round disc and imprint it, and permit R. C. Can Company to form it into a finished lid. Petitioner then originated some designs, developed a production process and a material to hold the design on the plastic, purchased and installed

machinery, hired employees, and went into experimental production of the imprinted plastic discs. However, when petitioner's printed discs were placed in the forming machinery operated by R. C. Can Company the inked designs were damaged. Also, the R. C. Can Company learned that it would have to have a special set of costly molds, and several machines, for each of its customers. The R. C. Can Company determined to discontinue their work on the plastic lid project, and petitioner started negotiations to buy the machinery from that company. A contract was drawn for the sale of the machinery to petitioner for $115,000 and was signed by the president of R. C. Can Co. Petitioner prepared its plant to receive the machinery, but after a last minute consultation with a large customer of R. C. Can Company, who advised against the project, petitioner withdrew from the deal. This occurred in about November 1961. During the year it worked on this project petitioner purchased some machinery at an undisclosed cost and used some which it already owned.

Sometime in 1960 Klein learned that a block of approximately 10 percent of the outstanding stock of Crystal Tissue Company was for sale for about $100,000. Crystal Tissue Company had been in the business of producing and selling decorated gift wrapping paper. Petitioner had done the lithographing work for that company which had for a while been petitioner's largest customer. However, such company had reached a point where it needed to rebuild its plant and two years earlier it had terminated operations, and petitioner had purchased its designs. The company intended to resume business of selling other consumer products. Klein thought it would be beneficial to petitioner to obtain an interest therein. His negotiations for the stock reached a point at which he thought a

purchase had been consummated. Instead, such block of stock was sold to the family which controlled Crystal Tissue. Petitioner, however, prior to these negotiations had purchased a small part of that company's outstanding stock for $500.

Sometime prior to January 1961, on petitioner's behalf, Klein had discussions with A.P.S. Company, a new corporation composed of the American Paper Specialty Company and two other companies. The American Paper Specialty Company had previously manufactured gift wrapping paper and similar items and the new company was formed to continue that business. Due to Klein's friendship with the persons who were forming the company he was invited to purchase some of its stock. In January 1961, petitioner purchased for $150,000 a 10 percent interest in A.P.S. Company and Klein became one of the directors. As a consequence, A.P.S. Company became a customer of Progress.

About April 1961, Klein became acquainted with the owner of the J.J. Hackett Company, a manufacturer of tabulating machine cards. Petitioner had never made a similar product, but Klein wanted to get in this new type of printing. The J.J. Hackett Company had plants in Chicago and Cincinnati, and Klein and the president of Hackett agreed to set up, as a separate corporation, a third plant in Detroit. Petitioner furnished 75 percent of the capital required by the new corporation, receiving 75 percent of the stock, and the J.J. Hackett Company furnished its experience as well as the remainder of the required capital. In addition, petitioner furnished the machinery for the new operation, for which it received rent from the new corporation. During the years involved herein, petitioner's total investment in capital and machinery for the new corporation was $50,000.

In May 1961, petitioner purchased, for $275,000, the Rapid American Building, a building occupied by three companies operating in the field of graphic arts. One of the occupants of the building, the Rapid Electrotype Company, was also offered for sale to petitioner, but petitioner did not purchase it.

In June 1961, petitioner purchased an interest in Magna Company for $72,000. That company was located in Cincinnati, but the record does not disclose what business it carried on. Klein negotiated the purchase as an investment and also for the purpose of attempting to obtain that company as a customer. Such company did become a customer, presumably of Progress.

In November 1961, Klein, on petitioner's behalf, began investigating the possibility of purchasing the John Baumgarth Company, a calendar manufacturer. Apparently the asking price was about $2,500,000. Klein received figures relating to the company's finances, visited its plant, and hired a company to research and report on the past history, present operations, and future prospects of the company in detail. Petitioner learned that Baumgarth (presumably the owner) had been in bankruptcy three or four times previously. After receiving the research report petitioner lost interest in acquiring such company.

In March 1963, Klein began discussions with the owners of Artistic Greeting Card Company, a company for which petitioner had acted as a supplier for 15 years with a view to a possible acquisition of an interest in that company. The family which owned that company desired to dispose of the business but to provide for future participation in the business by a young member of the family. Accordingly, they proposed to sell petitioner a 50 percent interest for about $1,900,000 and the young member of the

family the remaining 50 percent interest for $100,000. It was pointed out to petitioner that such person would also contribute his experience and other "intangible assets". Klein visited the plant several times and in August 1963, petitioner's tax counsel was permitted to examine the company's financial records. Thereafter a complete report was made. Klein met with the owners of the company in December 1963, at which time he proposed that petitioner make payment over a period of years and that a portion of the payment be made out of future profits of Artistic. The owners would not agree to this. As a consequence, Klein concluded that the owners lacked confidence in the future of the business, and decided the petitioner should not assume the risk involved when the owners refused to assume any part of the risk. He therefore broke off negotiations at that time. At no time was there any fear that petitioner would lose the Artistic Greeting Card Company as a customer.

At some undisclosed time during the years in question, Klein learned that a large block of stock in the Manz Company was for sale. The Manz Company was one of the largest lithography companies in Chicago, with a large well-equipped plant. It did a nationwide business. Klein travelled to Chicago, and learned that all or substantially all the stock of the company could be purchased for about $2,000,000 to $2,500,000. He was told that the company was in poor condition because new management "hadn't worked out" and "had thrown away a lot of money." Klein inspected the plant 2 or 3 times within a 2-week period, and, as a result of such visits, he determined that much of the work on hand did not represent orders from customers, but represented work done without charge to attract business. He took his tax counsel on one visit, at which time the company's finances were examined in detail. Klein came to the conclusion that the company was a desirable

purchase for the petitioner, but, since there were going to be further changes in the management, he thought it best to wait to see the results of those changes. However, another party bought the company for $2,200,000. The purchaser then offered to sell petitioner an interest in its combined companies, but petitioner declined the offer.

During the taxable years ended June 30, 1961, 1962, and 1963, petitioner paid net premiums of $24,857.05, $22,212.35, and $21,495.40, respectively, on life insurance policies on its officers and employees. The face values of these policies totalled $955,000. Of such premiums, the amounts of $22,350.20, $21,470.95, and $20,835.40 related to policies on the life of Klein, inasmuch as $875,000 of the total of face values of the policies was on his life.

The petitioner's accumulated earnings and profits as of the end of each of the taxable years in question were as follows:

Date	Accumulated Earnings and Profits	Increase Over Accumulation Beginning of Year
July 1, 1960	$4,772,080.74	—
June 30, 1961	4,919,779.18	$147,698.44
June 30, 1962	5,045,466.44*	125,687.26
June 30, 1963	5,131,035.42*	85,568.98

*The petitioner's returns show earned surplus and undivided profits at the end of these two years of $577,668.77 and $663,237.75, respectively, due to the fact that on October 16, 1961, an amount of $4,467,797.67 was transferred from its earned surplus account to its capital stock account.

Petitioner's assets and liabilities as of the beginning and end of each of the taxable years ended June 30, 1961 through 1963, were as follows:

ASSETS	July 1, 1960	June 30, 1961	June 30, 1962	June 30, 1963
Cash	$1,558,234.34	$1,948,251.20	$2,112,230.50	$1,768,253.27
Gov't Obligations	995,399.82	–0–	–0–	–0–
Notes & Accts. Receivable	103,917.38	47,071.98	98,308.36	26,625.52
Inventories	–0–	12,101.83	10,668.41	10,343.41
Investment in & amounts due from subsidiaries	1,527,327.06	1,645,369.28	1,502,807.98	1,573,537.37
Stocks, bonds, etc.	482,740.03	682,356.75	753,967.41	899,670.12
Bldgs. & depreciable assets	508,305.20	750,790.39	698,412.46	1,111,619.65
Land	35,407.85	88,515.63	88,515.63	117,345.63
Work in Process	348.75	348.75	348.75	348.75
Cash value of life insurance	186,209.05	209,412.96	228,316.14	252,566.58
Other assets	6,202.73	8,236.41	5,673.40	5,219.09
Total	$5,404,092.21	$5,392,445.18	$5,499,249.04	$5,765,529.39
LIABILITIES				
Accts. Payable	$ 12,208.55	$ 12,122.39	$ 12,845.15	$ 20,623.31
Mortgages, Notes and Bonds payable in less than 1 year				250,000.00
Salaries, Taxes, etc.	190,300.00	33,309.60	94,691.46	16,581.66
Deferred Federal taxes on income	250,000.00	250,000.00	187,500.00	187,500.00
Other Liabilities	27,300.59	25,031.68	6,643.66	7,586.67
Total	$ 479,809.14	$ 320,463.67	$ 301,680.27	$ 482,291.64

On its Federal income tax returns for the taxable years ended June 30, 1961 through 1963, the petitioner described its principal business activity as "Investments and Lessor of buildings." In such returns it reported taxable income computed as follows:

	1961	1962	1963
Net receipts:	$ 15,423.77	$ 1,828.62	$ 910.98
Less cost of goods sold:	28,164.86	7,691.17	1,741.79
Gross profit:	(12,741.09)	(5,862.55)	(830.81)
Dividends:	18,421.25	19,959.51	10,506.32
Interest:	105,391.82	157,096.03	103,316.18
Rents:	136,041.65	103,200.00	153,946.13
Net gains from sales of property:	1,484.82	236,498.03	23,275.94
Other income:	2,423.19	12.50	33.88
Total income:	$251,021.64	$510,903.52	$290,247.64
Total deductions:	160,449.17	180,453.59	215,385.30
Taxable income before special deductions:	$ 90,572.47	$330,449.93	$ 74,862.34
Special deductions (dividends received):	16,658.06	16,924.24	8,910.38
Taxable income:	$ 74,914.41	$313,525.69	$ 65,951.96

With respect to companies from whom petitioner reported having received dividend income during the years in question, it owned a controlling interest in only Progress, from which it received dividends of $3,200 each year. Of the dividends received in those years, at least $12,929.75, $12,702.28, and $3,675.83, respectively, was received from companies which were in no way related to petitioner, principally from Twin Coach Company, but also from such companies as Schenley Industries, Inc., Texas Gulf Sulphur Company, James B. Beam Distributing Co., and General Motors.

During each of the taxable years here involved, petitioner paid dividends of $15,400 to its shareholder. It paid salary to Klein at an annual rate of $42,000.

On February 17, 1967, respondent, pursuant to section 534(b) of the Internal Revenue Code of 1954, notified petitioner that he proposed to issue a notice of deficiency for the taxable years ended June 30, 1961 through June 30, 1963, setting forth an amount with respect to section 531 of the Code relating to the accumulated earnings tax. On April 13, 1967, petitioner, pursuant to section 534(c) of the Code, submitted a statement of the grounds on which it relied to establish that its earnings and profits had not been permitted to accumulate beyond the reasonable needs of its business.

By notice of deficiency dated June 2, 1967, the respondent determined that in each of the taxable years ended June 30, 1961, 1962, and 1963, the petitioner had permitted its earnings and profits to accumulate beyond the reasonable needs of its business for the purpose of avoiding the income tax with respect to its shareholders, and that the petitioner was taxable under the provisions of section 531 of the Code. Therein he determined that for each of the taxable years in question the petitioner was a holding or investment company within the meaning of section 533(b) of the Code. He determined accumulated taxable income for those years in the respective amounts of $39,034.73, $44,116.98, and $22,444.41. In his computation of accumulated taxable income the respondent did not allow any accumulated earnings credit.

On February 23, 1968, petitioner moved that this Court find that its statement filed pursuant to section 534(c) was sufficient to place the burden of proof on respondent with respect to the grounds set forth in the statement on which the petitioner relied to establish that its earnings and profits had not been permitted to accumulate beyond the reasonable needs of its business. After hearing was had up-

on such motion on March 27, 1968, this Court, on April 5, 1968, entered an order denying the motion.

ULTIMATE FINDING OF FACT.

During each of the taxable years ended June 30, 1961, 1962, and 1963 the petitioner permitted its earnings and profits to accumulate beyond the reasonable needs of its business.

OPINION.

The accumulated earnings tax imposed by section 531 of the Internal Revenue Code of 1954 applies, with certain exceptions, to any corporation formed or availed of for the purpose of avoiding the income tax with respect to its shareholders by permitting earnings and profits to accumulate instead of being divided or distributed. There are set forth in the margin pertinent sections of the Internal Revenue Code of 1954.[2]

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2. SEC. 531. IMPOSITION OF ACCUMULATED EARNINGS TAX.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax * * *.

SEC. 532. CORPORATIONS SUBJECT TO ACCUMULATED EARNINGS TAX.

(a) General Rule.—The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

* * *

SEC. 533. EVIDENCE OF PURPOSE TO AVOID INCOME TAX.

(a) Unreasonable Accumulation Determinative of Purpose.—For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate be-

Section 533(b) provides that the fact that any corporation is a mere holding or investment company shall be prima facie evidence of the purpose to avoid the income tax with respect to shareholders. One of the respondent's contentions is that during the taxable years in question the petitioner was such a mere holding or investment company, stating, among other things, that practically all of petitioner's income reported was passive, namely, dividends, interest, rent, and gains from the sales of stocks

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yond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

(b) Holding or Investment Company.—The fact that any corporation is a mere holding or investment company shall be prima facie evidence of the purpose to avoid the income tax with respect to shareholders.

SEC. 535. ACCUMULATED TAXABLE INCOME.

(a) Definition.—For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

* * *

(c) Accumulated Earnings Credit.—

(1) General rule.—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b)(6). * * *

* * *

(3) Holding and investment companies.—In the case of a corporation which is a mere holding or investment company, the accumulated earnings credit is the amount (if any) by which $100,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

* * *

SEC. 537. REASONABLE NEEDS OF THE BUSINESS.

For purposes of this part, the term "reasonable needs of the business" includes the reasonably anticipated needs of the business.

or securities. He cites section 1.533-1(c) of the Income Tax Regulations.[3] The petitioner denies that it was a mere holding or investment company, contending that it was actively engaged in research and development, a search for diversification, and the acquisition of additional plants, even though the production was carried on through subsidiaries.

We find it unnecessary to resolve the issue of whether the petitioner was a mere holding or investment company, since, irrespective of that question, it is our opinion that the petitioner has failed to meet its burden of showing that it was not availed of for the purpose of avoiding the tax on its sole shareholder, Charles H. Klein.

The respondent also contends that the petitioner's earnings and profits for the years in question were accumulated beyond the reasonable needs of its business. Section 533(a) provides that the fact that the earnings and profits are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary. The burden of proof was upon the petitioner to show that the earnings and profits were

3. Such regulation provides as follows:

Holding or investment company. A corporation having practically no activities except holding property and collecting the income therefrom or investing therein shall be considered a holding company within the meaning of section 533(b). If the activities further include, or consist substantially of, buying and selling stocks, securities, real estate, or other investment property (whether upon an outright or marginal basis) so that the income is derived not only from the investment yield but also from profits upon market fluctuations, the corporation shall be considered an investment company within the meaning of section 533(b).

not permitted to accumulate beyond the reasonable needs of the business.[4]

The petitioner's principal contention appears to be that throughout the three taxable years in question it actually expended more for plant and equipment than the total of its earnings and profits for those years available for distribution, and that therefore it cannot be considered that such earnings and profits were accumulated beyond the reasonable needs of its business, but it also stated as a reason for its accumulations that the acquisition of plants looked at and negotiated for would have required an investment of up to $5,000,000. We have consistently held that in determining whether the earnings and profits of any taxable year have been accumulated beyond the reasonable needs of the business, it is necessary to consider whether accumulated earnings and profits of prior years were sufficient to meet the taxpayer's reasonable business needs of the taxable year, including reasonably anticipated needs. There must, of course, be taken into consideration the availability of the prior years' accumulated surplus. Thus, to the extent that such accumulated surplus has been translated into plant expansion or inventories or other assets related to the business, it is not available for meeting current or anticipated business needs. On the other hand, at least to the extent that such accumu-

4. In this connection it should be pointed out that on brief the petitioner makes the argument that in view of the statement which it submitted, pursuant to section 534(c) of the Code, the burden of proof is upon the respondent with respect to the grounds stated therein upon which petitioner relied to establish that its earnings and profits had not been permitted to accumulate beyond the reasonable needs of its business. However, as pointed out in the Findings of Fact, prior to trial this Court entered an order denying the petitioner's motion that the Court find that such statement was sufficient to place the burden of proof in this respect upon the respondent. The intention of the Court and the effect of the order was to hold, in advance of the trial, that the petitioner's statement was not sufficient to place the burden of proof upon the respondent, and that such burden remained upon the petitioner.

lated surplus is reflected in liquid assets, it is available to meet business needs, and if sufficient to meet the current and reasonably anticipated business needs of the corporation there is a strong indication that any accumulation of earnings and profits of the current year is beyond the reasonable needs of the business. *Wellman Operating Corporation,* 33 T.C. 162; *John P. Scripps Newspapers,* 44 T.C. 453; *Smoot, Sand & Gravel Corporation* v. *Commissioner,* (C.A. 4) 274 F.2d 495, certiorari denied 360 U.S. 976, affirming a Memorandum Opinion of this Court; section 1.535-3 (b) (1) (ii) of the Income Tax Regulations; and S. Rept. No. 1622, 83d Cong., 2d Sess., p. 317.[5]

Here the petitioner, as of the beginning of the taxable year ended June 30, 1961, had accumulated earnings and profits from prior years in the amount of $4,772,080.74, of which $1,553,234.34 was represented by cash and $1,478,139.85 was represented by investments in Government obligations and stocks, bonds and other securities. It is against this background that we must consider whether the earnings and profits of the taxable years in question were permitted to accumulate beyond the reasonable needs of the business.

The reasonable needs of a business include the reasonably anticipated needs of such business. Section 537 of the Code. However, where the future needs of the business, as determined in the light of the facts existing as of the end of the taxable year, are uncertain or vague or the plans for the future use of an accumulation are not specific and definite, an accumulation cannot be justified

5. Such report states in part:

> In determining the portion, if any, of the earnings and profits for a taxable year which may be retained for the reasonable needs of the business, and amount of the earnings and profits accumulated in prior years shall, of course, be taken into account.

on the grounds of reasonably anticipated needs. See section 1.537-1(b) of the Income Tax Regulations,[6] and H. Rept. No. 1337, 83rd Cong., 2nd Sess., p. A173.[7]

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6. Such section provides in part as follows:

(b) *Reasonably anticipated needs.* (1) In order for a corporation to justify an accumulation of earnings and profits for reasonably anticipated future needs, there must be an indication that the future needs of the business require such accumulation, and the corporation must have specific, definite, and feasible plans for the use of such accumulation. Such an accumulation need not be used immediately, nor must the plans for its use be consummated within a short period after the close of the taxable year, provided that such accumulation will be used within a reasonable time depending upon all the facts and circumstances relating to the future needs of the business. Where the future needs of the business are uncertain or vague, where the plans for the future use of an accumulation are not specific, definite, and feasible, or where the execution of such a plan is postponed indefinitely, an accumulation cannot be justified on the grounds of reasonably anticipated needs of the business.

(2) Consideration shall be given to reasonably anticipated needs as they exist on the basis of the facts at the close of the taxable year. Thus, subsequent events shall not be used for the purpose of showing that the retention of earnings of profits was unreasonable at the close of the taxable year if all the elements of reasonable anticipation are present at the close of such taxable year. However, subsequent events may be considered to determine whether the taxpayer actually intended to consummate or has actually consummated the plans for which the earnings and profits were accumulated. In this connection, projected expansion or investment plans shall be reviewed in the light of the facts during each year and as they exist as of the close of the taxable year. If a corporation has justified an accumulation for future needs by plans never consummated, the amount of such an accumulation shall be taken into account in determining the reasonableness of subsequent accumulations.

7. Such House Report provides as follows:

It is intended that this provision will make clear that there is no requirement that the accumulated earnings and profits be invested immediately in the business so long as there is an indication that future needs of the business require such accumulation. In any case where there exists a definite plan for the investment of earnings and profits, such corporation need not necessarily consummate these plans in a relatively short period after the close of the taxable year. However, where the future needs of the business are uncertain or vague, or the plans for the future use of the accumulations are indefinite, the amendment does not prevent application of the accumulated earnings tax.

It should be further observed that the need to retain earnings and profits must be directly connected with the needs of the corporation itself and be for bona fide business purposes (section 1.537-1(a) of the Income Tax Regulations), but that the business of the corporation is not merely that which it has previously carried on but includes any line of business which it may undertake. Section 1.537-3 of the regulations[8] provides that the business of a corporation may include the business of another corporation if such other corporation is a mere instrumentality of the first corporation, and that this may be established by showing that the first corporation owns at least 80 percent of the voting stock of the second corporation. However, if the ownership of stock in the second corporation is less

8. Section 1.537-3 of the regulations provides as follows:

Business of the corporation.—(a) The Business of a corporation is not merely that which it has previously carried on but includes, in general, any line of business which it may undertake.

(b) If one corporation owns the stock of another corporation and, in effect, operates the other corporation, the business of the latter corporation may be considered in substance, although not in legal form, the business of the first corporation. However, investment by a corporation of its earnings and profits in stock and securities of another corporation is not, of itself, to be regarded as employment of the earnings and profits in its business. Earnings and profits of the first corporation put into the second corporation through the purchase of stock or securities or otherwise, may, if a subsidiary relationship is established, constitute employment of the earnings and profits in its own business. Thus, the business of one corporation may be regarded as including the business of another corporation if such other corporation is a mere instrumentality of the first corporation; that may be established by showing that the first corporation owns at least 80 percent of the voting stock of the second corporation. If the taxpayer's ownership of stock is less than 80 percent in the other corporation, the determination of whether the funds are employed in a business operated by the taxpayer will depend upon the particular circumstances of the case. Moreover, the business of one corporation does not include the business of another corporation if such other corporation is a personal holding company, an investment company, or a corporation not engaged in the active conduct of a trade or business.

than 80 percent the determination of whether the funds are employed in a business operated by the first corporation will depend upon the circumstances of the case. See also H. Rept. No. 1337, 83rd Cong., 2nd Sess., p. 53.[9] The regulations further provide that an accumulation for the purpose of acquiring a business enterprise through the purchase of stock or assets, or to make investments or loans to suppliers or customers if necessary to maintain the corporation's business, may constitute an accumulation for the reasonable needs of the business. Section 1.537-2(b) of the Income Tax Regulations. However, accumulations of earnings and profits to make investments in properties or securities which are unrelated to the activities of the business of the taxpayer-corporation may not be considered as accumulations to meet the reasonable needs of the business. See *Kerr-Cochran, Inc.*, 30 T.C. 69, and section 1.537-2(c) of the Income Tax Regulations.

On or about January 1, 1960, the petitioner transferred all its manufacturing assets to its subsidiary, Progress, and thereafter, throughout the years in question, that company carried on the lithographing business previously carried on by the petitioner, and the petitioner thereafter continued its research and development activities in the field of

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9. H. Rept. No. 1337, 83rd Cong., 2nd Sess., contains the following at p. 53:

> Another subject of controversy in the administration of section 102 has been the use of retained earnings for the purpose of acquiring another business enterprise. Under existing interpretations, retained earnings may be invested in a business enterprise operated directly by the taxpayer, but doubt exists as to the operation of such a business through a subsidiary corporation controlled by the taxpayer. Your committee is of the opinion that where the taxpayer has 80 percent or more of the voting stock of another corporation, the taxpayer should be viewed as though it engaged directly in the business of such other corporation. If the taxpayer's ownership of stock is less than 80 percent in such other corporation, a factual determination should be made as to whether the funds so invested are employed in a business operated by the taxpayer. * * *

lithography. However, since petitioner owned 80 percent of the voting stock of Progress, the business of the latter will be considered as the business of the petitioner.

As of the end of the taxable year ended June 30, 1961, there existed a need for additional plant space to carry out the existing lithography business then being carried on by Progress. In 1959 the board of directors had instructed Klein, its president, to obtain preliminary cost estimates in order that a decision could be made as to whether a new plant should be built or an existing plant expanded. The evidence does not show whether, as of the end of the taxable year ended June 30, 1961, that decision had been made and, if so, the anticipated cost involved. However, the evidence does show that approximately 6 months after the close of such year the petitioner started negotiations for buying an existing plant, the Mitchell Avenue plant. The asking price was $1,500,000, but the petitioner considered that price too high and finally, in September 1962, such plant was purchased by petitioner for $532,000. Under these circumstances, we think it reasonable to conclude that as of the end of the taxable year ended June 30, 1961, one of the reasonably anticipated needs of the business was additional plant space to cost approximately $532,000. This was also the situation at the end of the taxable year ended June 30, 1962.

Sometime in 1967, which was at least three and a half years after the close of the last taxable year here involved, the petitioner purchased a plant in North Vernon, Indiana, at a cost between $750,000 and $1,000,000. The evidence shows that during the taxable years here involved the petitioner had no specific and definite plan to purchase this or any other particular plant, other than the Mitchell Avenue plant. And, although Klein testified that it was contemplated that some expenditure would be made for a plant

at some time in the future, he also stated that it was not known how much would be spent since that would depend upon the market and the facilities which would be required. Thus, during the taxable years here involved the petitioner's future plant needs were so vague and uncertain and its plans for the future use of funds for that purpose so indefinite that we cannot conclude that it had any reasonably anticipated need for funds for plant acquisition over and above the above anticipated expenditure of $532,000.

Minutes of meetings of the board of directors of the petitioner state that the officers and directors had undertaken a program of acquiring other business enterprises. Such policy was general in nature and it was contemplated that Klein would first investigate any possible acquisitions before determining which were worthy of consideration. In determining the reasonably anticipated needs of the business in this respect there may be taken into consideration only those plans for acquisitions which, as of the end of a particular taxable year, were specific and definite.

In 1957 or 1958 Klein became interested in the possibility of purchasing for petitioner an interest in the U. O. Colson Company, which manufactured lithographed calendars, but which was not a supplier, customer or competitor of the petitioner. In June 1960 the board of directors of petitioner authorized Klein to take necessary action to invest funds, the amount being unspecified, of the petitioner in the capital stock of that company. Klein became a director of the Colson Company and from time to time discussed with its president, U. Gordon Colson who owned a majority interest, the possibility of purchasing an interest. However, the petitioner never did acquire an interest in that company, and Klein testified that "the

thought of acquiring the company continued" until late 1967[10] when the assets of such company were sold to another. While in his testimony Klein spoke of acquiring the company, the record fails to show how much the petitioner had in mind might be invested in the Colson Company or how much of an interest in that company might be purchased. Klein testified that he "didn't feel it was worth an investment of a million and a half dollars and we didn't go any further." Whether the amount referred to by Klein represented the asking price for Colson's majority interest, or some other percentage interest, we cannot determine from the evidence. In any event, the record falls far short of establishing that the petitioner had in mind acquiring the business enterprise and operating it. Rather, insofar as the record shows, the intention was merely to make an investment in the stock of the Colson Company, which would represent an investment in securities unrelated to the petitioner's business activities. Furthermore, the record does not establish to our satisfaction that as of the end of any of the taxable years before us there was a specific and definite plan to purchase an interest in the Colson Company. We are not informed as to when Klein decided that it was not advisable to invest as much as was apparently asked for an interest in the Colson Company. For all that appears, this may have happened during the taxable year ended June 30, 1961, and thereafter there was no definite expectation or intention of acquiring an interest in that company. Accordingly, the petitioner has not established that as of the end of any of the taxable years in question there was a reasonable

10. The transcript of testimony shows the time as "late 1957." However, such date is obviously incorrect since it was not until June 18, 1960, that petitioner's board of directors considered the matter of investment in that company. From the record we think it reasonable to conclude that the correct time was "late 1967." However, whether it was late 1967 or some other date after June 18, 1960, is, in our opinion, immaterial.

business need for funds for the purpose of acquiring an interest in the Colson Company.

In July or August 1960, the petitioner set up a subsidiary, Electroshred Corporation, to enter into the production of paper shredding machines. It was anticipated that from $200,000 to $300,000 would be expended in this venture. The evidence shows that during the three taxable years before us the petitioner invested about $50,000 in this project, but the amount invested in each year is not shown. Accordingly, viewing the situation as it existed at the end of the taxable year ended June 30, 1961, we think there was a reasonably anticipated need of the business of petitioner of about $250,000 for this purpose. This was also the situation at the end of the taxable year ended June 30, 1962. However, in the taxable year ended June 30, 1963, due to unforeseen circumstances, the project was abandoned, with the result that thereafter there was no further need in this respect.

During the taxable year ended June 30, 1961, the petitioner undertook a "plastic lid project" under an agreement with another company which provided that the petitioner would perform a part of the manufacturing process. The evidence is not clear as to how much was spent on the project or when any expenditures were made. Klein testified that petitioner bought some machinery and used some it already owned, so that petitioner "had like a hundred thousand dollars" worth of machinery and time in it for the year it worked on the project. Nor does the evidence establish what amount, if any, might represent the reasonably anticipated need of the petitioner with respect to this project as of the end of the taxable year ended June 30, 1961. During the taxable year ended June 30, 1962, the project was abandoned.

Sometime in 1960 petitioner attempted to purchase a 10 percent interest in Crystal Tissue Company, the asking price of which was $100,000. However, at an undisclosed time someone else purchased the interest. The evidence with regard to this prospective purchase is so meager that we cannot determine whether or not it was in prospect at the end of the taxable year ended June 30, 1961. In addition, it is not established that the purpose in purchasing such an interest would be to maintain the petitioner's business rather than merely make an investment in securities unrelated to petitioner's business activities. Under the circumstances, we cannot find that as of the end of any one of the taxable years in issue there was a reasonable business need for such an investment.

In January 1961, the petitioner purchased for $150,000 a 10 percent interest in A.P.S. Company. Since, as a consequence, that company became a customer of Progress, such expenditure might be considered as satisfying a reasonable need of petitioner's business. However, there is no showing that as of the end of any of the taxable years in question there was any need for further accumulation in connection with such acquisition.

At some undisclosed time after April 1961, the petitioner and the president of J.J. Hackett Company set up a new corporation for the purpose of manufacturing tabulating machine cards, the petitioner acquiring 75 percent of the stock. Since we do not know when this transaction occurred, we do not know whether at the end of any of the taxable years involved herein, the petitioner had any reasonably anticipated need for funds with respect to this project. All we know is that the petitioner's total investment in capital and machinery for the new corporation was $50,000 during the three taxable years involved herein, but we do not know how much was invested in each year.

In May 1961, petitioner purchased, for $275,000, the Rapid American Building. We are not persuaded by the evidence that petitioner intended to use this building for any purpose other than rental. In any event, there is no showing that as of the end of any of the taxable years there was any need for further accumulations in connection with such acquisition.

In June 1961, the petitioner purchased an interest in Magna Company for $72,000. Since one of the purposes was to obtain that company as a customer the expenditure may well have satisfied a reasonable need of petitioner's business. However, there is no showing that as of the end of any of the taxable years in question there was any need for further accumulations in connection with the interest acquired in such company.

In November 1961, Klein, on petitioner's behalf, began investigating the possibility of purchasing the John Baumgarth Company, the asking price for which was about $2,500,000. However, at some undisclosed time, after receiving a research report, the petitioner abandoned any idea of acquiring this company. Under the circumstances, we cannot find that as of the end of either of the taxable years ended June 30, 1962 or June 30, 1963, the petitioner had any reasonably anticipated need for funds with respect to the purchase of such company.

In March 1963 Klein commenced discussions with the owners of Artistic Greeting Card Company with regard to the possible acquisition of an interest in that company. The family which owned that business proposed to sell petitioner a 50 percent interest for about $1,900,000 and the remaining 50 percent interest to a younger member of the family for $100,000, it being pointed out to petitioner that such member of the family would also contribute his experience and certain "intangible assets." Klein's investi-

gation of the company, which included inspection of the company's financial records by petitioner's tax attorney in August 1963, continued until December 1963 when Klein decided that it would be inadvisable for petitioner to assume the risk of such an undertaking, and therefore broke off all negotiations. The evidence is so meager that we must conclude that petitioner has not shown that it ever contemplated the possibility of acquiring the business enterprise and operating it, as distinguished from making a passive investment therein. The fact that the proposal was to have a member of the family of the owners of the business pay such a small amount for a half interest, as compared with the petitioner's proposed payment, coupled with the fact that such family member was to contribute his experience and other benefits to the business, casts doubt upon the question. Moreover, the evidence does not establish that as of the end of the taxable year ended June 30, 1963, there was a definite plan to purchase any interest in that company. The evidence indicates that up to that time Klein had been engaged in nothing more than discussions of possibilities, and that not until after the end of the year was there even any investigation of the financial condition of the company. See *Wellman Operating Corporation, supra.* Furthermore, when Klein did conduct negotiations with regard to purchase terms in December 1963, he proposed that a part of the price be paid out of future earnings of the business of Artistic Greeting Card Company. For all that appears this may have been contemplated from the beginning. Under the circumstances we cannot conclude that as of the end of the taxable year ended June 30, 1963, the petitioner has shown that it had any reasonably anticipated business need to accumulate funds to purchase an interest in the Artistic Greeting Card Company. Moreover, even if it were concluded that at the end of such year there was a reasonably anticipated business

need for funds to purchase an interest in that company, this would not justify the accumulation of any earnings and profits of the taxable year ended June 30, 1963, since as pointed out *infra*, the petitioner had sufficient available earnings accumulated from prior years to more than provide the necessary funds.

At some undisclosed time during the taxable years in question the petitioner considered the purchase of a large block of stock in the Manz Corporation, which was in the lithography business. Substantially all the stock of that company was offered for sale for about $2,000,000 to $2,500,000. At some undisclosed time another party bought the company. Since this is all the evidence shown, obviously it is insufficient to show that as of the end of any of the taxable years here involved the petitioner had any reasonably anticipated need for funds in connection with the acquisition of an interest in such company.

At June 30, 1961, the petitioner had accumulated earnings and profits, exclusive of earnings and profits of that taxable year, of $4,772,080.74. At that time it also had liquid assets including cash of $1,948,241.20 and stocks, bonds, and other securities of $682,356.75. Thus, at the end of the taxable year ended June 30, 1961, the petitioner had accumulated earnings and profits of prior years, in liquid form, far in excess of any proven reasonable needs of the business for that year, including any reasonably anticipated future needs. The only reasonable needs including anticipated needs, shown as of that time amounted to $782,000. The same is true with respect to the taxable years ended June 30, 1962 and June 30, 1963. As of June 30, 1962, the petitioner had accumulated earnings and profits, exclusive of earnings and profits of the taxable year ended June 30, 1962, of $4,919,779.18 and had cash and securities of $2,866,197.91, whereas the proven needs

amounted to $782,000. As of June 30, 1963, petitioner had accumulated earnings and profits, exclusive of earnings and profits of the taxable year ended June 30, 1963, of $5,045,466.44 and had cash and securities of $2,667,923.39, whereas it did not prove any reasonable needs as of that time.

The petitioner paid dividends of only $15,400 for each of the taxable years in question, whereas its retained earnings and profits for those three years amounted to $147,698.44, $125,687.26, and $85,568.98, respectively.

In view of the foregoing, we have concluded and have found as a fact that during the years in question petitioner permitted its earnings and profits to accumulate beyond the reasonable needs of its business. Section 533(a) provides that such fact shall be determinative of the purpose to avoid the income tax with respect to the shareholders unless the corporation by the preponderance of the evidence shall prove to the contrary.[11] The petitioner has introduced no evidence to rebut the presumption contained in section 533(a). Accordingly, we hold that petitioner has not shown that it was not availed of during the years in question for the purpose of avoiding the income tax with respect to its shareholder by permitting its earnings and profits to accumulate instead of being divided or distributed.

The petitioner further contends that the accumulated taxable income for each year, which is the basis upon

11. In *United States* v. *The Donruss Company*, 393 U.S. 297 (January 13, 1967) [23 AFTR 2d ....., para. 69-418], the Supreme Court held that in order to rebut the presumption contained in section 533(a) the taxpayer must establish that tax avoidance with respect to its shareholders was not "one of the purposes" for the accumulation of earnings beyond the reasonable needs of the business and that it is not sufficient to prove that tax avoidance was not the "dominant, controlling, or impelling" reason for the accumulation.

which the tax is computed (section 531), should be reduced by the amounts it expended to pay premiums on insurance on the lives of Klein and other key employees.

Section 535(a) of the Code defines "accumulated taxable income" as the taxable income, with certain adjustments (none of which would include life insurance premiums) minus the dividends paid deduction and the accumulated earnings credit. The petitioner states that it was the owner of the policies and concedes that, in view of the provisions of section 264(a) (1) of the Code,[12] such premiums are not deductible in computing taxable income, yet it has not pointed to any other provision of the law which would permit the reduction of accumulated taxable income. It does not contend that the payment of the premiums constituted dividends for purposes of the dividends paid deduction, nor does it contend that they should be included in the calculation of the accumulated earnings credit provided for by section 535(c). It merely states on brief that "premium on the life insurance was proper; was paid out; was no longer available for distribution; did not constitute an accumulation; and should have been considered in determining the remaining earnings during the taxable years available for distribution."

Since Congress has specifically provided for the deductions and adjustments to be taken into account in computing accumulated taxable income, and since we cannot find that these insurance premiums fall within any of the prescribed deductions or adjustments, we conclude that there is no merit in this contention of the petitioner.

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12. Section 264(a)(1) of the Code provides:

(a) General Rule.—No deduction shall be allowed for—

(1) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

In view of the foregoing, we hold that for the taxable years in question the petitioner is subject to the accumulated earnings tax imposed by section 531 of the Code, and the respondent's determination is approved.

Decision will be entered for the respondent.

DECISION

(Filed September 18, 1969)

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed August 11, 1969, it is

ORDERED and DECIDED: That there are deficiencies in income tax for the taxable years ended June 30, 1961, 1962 and 1963 in the respective amounts of $10,734.55, $12,132.17, and $6,172.21.

Entered: SEP 18, 1969

(Signed) Craig S. Atkins
Judge

(Seal)